

SENATE TAXATION
EXHIBIT NO. 5
DATE 1.18.10
BILL NO. SB 70

Minority of States Still Granting Net Operating Loss “Carryback” Deductions Should Eliminate Them Now

By Michael Mazerov

Revised May 11, 2009

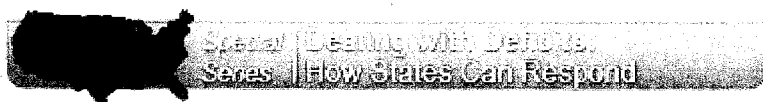
Related Areas of Research

State Budget and Tax

Federal-State Issues

States in the Recession

Taxes



Summary

As a result of the current recession, nearly all states are experiencing the most serious fiscal crisis of at least the last 25 years. Many are already being forced to cut vital services, lay off employees, increase taxes and college tuitions, and tap reserves. In this context, they can ill-afford maintaining any policies that worsen their financial problems.

Yet 19 states (see the box at right) are at risk of compounding their fiscal difficulties because of a somewhat obscure feature of their income tax codes known as the net operating loss (NOL) “carryback” deduction.

[i] This provision allows businesses to file amended income tax returns for past years in which they were profitable, use current year business losses to offset those profits, and receive refunds of taxes paid in past years. During recessions, when tax payments by businesses tend to fall in any case, refunding business taxes paid in *prior* years can make revenue shortfalls even larger.

These 19 states could avoid some loss of personal and/or corporate income tax revenue during the current fiscal crisis — and future recessions — if they act now to disallow NOL carrybacks. (Personal income tax revenues would be affected because businesses organized as sole proprietorships and partnerships are also permitted to carry back

Key Findings

Nineteen states could avoid unnecessarily com-pounding their fiscal problems during the current economic downturn by repealing deductions from their personal and/or corporate income taxes for “net operating loss carrybacks.” The states are:

Alaska	Mississippi
Delaware	Missouri
Georgia	Montana
Hawaii	New York
Idaho	Ohio
Indiana	Oklahoma
Iowa	Utah
Louisiana	Virginia
Maryland	West Virginia
Michigan	

These states allow businesses to use current losses to offset past profits and receive refunds of prior-year taxes paid — at exactly the time that current-year tax collections are falling.

The majority of states don't grant NOL carryback deductions.

All states already provide almost the same tax benefit to businesses by

NOLs.) [iii] Three states — Kentucky, Illinois, and North Dakota — repealed their NOL carryback deductions during the years of tight state finances that followed the 2001 recession.

The underlying objective of permitting an NOL carryback deduction is reasonable from the standpoint of tax policy. [iiii] The provision allows a business to calculate taxable profit by averaging its income — including negative income — over several years. Allowing businesses to average profitable years and loss years recognizes both that start-up businesses often incur losses for several years before they become profitable and that many businesses experience temporary losses in the course of an economic downturn.

This income-averaging policy can be substantially achieved, however, by permitting "loss carryforwards" — allowing businesses to deduct any losses they suffer against *future* profits. The tax savings provided by carrybacks and carryforwards is essentially the same, with the principal difference being a matter of timing. Given that the objective of loss carrybacks can largely be achieved by allowing losses to be carried forward, it is ill-advised for states to compound their fiscal difficulties by issuing refunds for previously-paid taxes at a time when their current-year personal and corporate income tax collections are being affected adversely by an economic slowdown or recession. Loss carrybacks conflict with state balanced budget requirements, which force states to balance current year budgets even when the economy is weak, revenues are flagging, and service needs are rising.

A majority of states already apparently recognize the advantages of limiting income averaging by businesses to prospective deductions; 26 states and the District of Columbia permit losses to be carried forward to reduce future tax liabilities but bar loss carrybacks. [iv] Policymakers who wish to avoid an unnecessary revenue loss in their states' 2010 and 2011 fiscal years could do so by amending their tax laws to disallow the carryback of calendar 2009 operating losses experienced by businesses to earlier tax years.

If states act quickly, it is even possible to disallow the carryback of 2008 losses incurred by corporations. Such action would still be timely; the vast majority of corporations did not file their income tax returns prior to April 15th but rather will do so toward the end of this summer or even later. Disallowing the carryback of 2008 operating losses would significantly reduce the amount of refunds states will have to issue during their 2010 fiscal years as a result of the NOL carryback provision. Quick action is important because corporate profits were still high in 2006 and 2007 and most states that permit carrybacks allow a two-year carryback period.

Quick action may be especially important for Alaska, Delaware, Michigan, Missouri, New York, Ohio, and Oklahoma. These seven states tie the amount of NOL carrybacks they grant to corporations and/or individuals to the federal income tax carryback rules. Legislation has recently been introduced in the U.S. Senate to lengthen the NOL carryback period from two years to five years. Were this legislation to be enacted, it would significantly increase the amount of tax revenue these seven states would have to refund if they fail to repeal their carryback provisions.

[Click here to read the full-text PDF of this report \(9pp.\)](#)

End Notes:

[i] John C. Healy and Michael S. Schadeewald, 2009 Multistate Corporate Tax Guide on CD-ROM, CCH, validated

allowing them to use current losses to offset future profits — a policy that is not nearly as disruptive to state fiscal management.

7 of these 19 states could be especially hard-hit if they don't repeal their carrybacks because of direct links between their carryback laws and the federal tax code; legislation has been introduced to grant bigger NOL carrybacks to corporations.

with selective review of state corporate income tax statutes.

[ii] In Michigan and Ohio, the operating loss carryback provision applies only to individual income taxes.

[iii] That is not to say, however, that granting carrybacks or lengthening the carryback period is justified as a means of stimulating state or federal economic growth. At the state level, the loss of revenue from granting or extending carrybacks requires offsetting cuts in state spending or tax increases that reduce economic demand to the same extent, providing no net boost to economic growth. At the federal level, refunding additional income to corporations during a recession is unlikely to boost their investment significantly since the major roadblock to such investment is likely to be insufficient demand for their products. See: Aviva Aron-Dine, "Net Operating Loss Measure Under Consideration in Senate Has Low Bang-for-the-Buck as Stimulus: No Justification for Waiving PAYGO for the Provision," Center on Budget and Policy Priorities, February 26, 2008.

[iv] Five states do not have corporate or personal income taxes for which NOL carrybacks are relevant. They are Nevada, South Dakota, Texas, Washington, and Wyoming.

[About](#) [Areas of Research](#) [Policy Basics](#) [Experts](#) [Donate](#) [Press Room](#) [Jobs](#) [RSS](#) [Contact Us](#) [Privacy Policy](#)

Center on Budget and Policy Priorities 820 First Street, NE, Suite 510 Washington, DC 20002 Ph: 202-408-1080 Fax: 202-408-1056 center@cbpp.org

Contact the [web team](#) with questions or comments about the site.

Copyright © 2008 - 2010 Center on Budget and Policy Priorities. All rights reserved.

Created by [Matrix Group International, Inc.](#)